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SUBJECT: AMB ORDWAY MEETS WITH SHKOLNIK AND KULIBAYEV;
DISCUSSES BTC, CPC AND KASHAGAN

11. (SBU) Summary: Ambassador Ordway met with Minister of Energy and Mineral Resources Vladimir Shkolnik March 4 in Astana. They discussed developments in the negotiations between Kazakhstan and Azerbaijan on the provision of Kazakhstani oil to the Baku-Tbilisi Ceyhan (BTC) pipeline, expansion of the Caspian Pipeline Consortium (CPC) line and prospects for conclusion of the negotiations for Kazakhstan's purchase of a stake in the Kashagan field. President Nazarbayev's son-in-law and first vice-president of KazMunayGas (KMG) Timur Kulibayev also participated. End Summary.

Aktau-BTC Developments

12. (SBU) Concerning BTC, the Minister informed the Ambassador that the next round of meetings with the Azeri side will take place March 18 in Baku. While in principle progress appears to be taking place, serious discussions still need to be had on the issue of taxation. In Shkolnik and Kulibayev's opinion, the taxation scheme for BTC should proceed from the notion that the Kazakhstani port of Kuryk (south of Aktau) is the point of origin for the Kazakhstani oil in the BTC line. They perceive that Azerbaijan wishes to consider the lines from the production facilities to the terminal as part of the system for taxation purposes, and find this concept unreasonable. [Comment: According to both Kazakhstani working-level sources and an AGIP-KCO consortium partner, the GOK and the consortium partners radically differ on oil transport from Kashagan to Aktau. The consortium believes the Kashagan PSA gives them the right to build or not to build the pipeline from the field to Aktau. The GOK believes they have this right and want to control it. It does not like the BTC model, which gives the pipeline consortium control from wellhead to Ceyhan in Turkey. A U.S. member of the Kashagan consortium said getting the oil to Aktau worries him more than getting it across the Caspian. End Comment].

13. (SBU) Shkolnik seemed slightly pessimistic about the process and criticized the Azeris for a lack of flexibility. For his part, Kulibayev appeared more sanguine about the prospects for an agreement.

CPC Expansion

14. (SBU) The Ambassador and Shkolnik also discussed the next steps to be taken since the decision was reached by the CPC partners to expand the system. Shkolnik expressed his satisfaction that the parties had agreed on expansion, but judged that rather little time, perhaps a month, remains to get an advantageous settlement of the remaining issues, particularly the commercial terms. Shkolnik's urgency is based on a belief that the Russian participant in CPC will change - that Rosneft will become the Russian operator rather than the Ministry of Energy and Industry, which Shkolnik views as a negative development. Shkolnik criticized U.S. companies for inflexibility, which he thinks may prevent agreement before Rosneft becomes a player.

Kashagan State of Play

15. (SBU) Shkolnik also told the Ambassador that the GOK was meeting with the Kashagan consortium partners March 4 in London. The Ambassador asked Shkolnik which issues were still being negotiated, and the Minister replied, "(a)ll of them." Shkolnik reported that the Kazakhstani side is now offering about \$1 billion for half of British Gas (BG's) stake in the consortium, or 8.33% of the whole. Shkolnik maintained that while Kazakhstan was only bidding on 8.33%

now, he considers that it still has and would continue to have a priority right to buy the other half of the stake.[Note: The Chinese were to purchase a 16.67% for \$1.23bn. The elevated price reflects Capex investments made

. End Note]

16. (SBU) Shkolnik said that he still sees two main issues: the purchase itself, and the changes that would be made to the consortium arrangements (e.g. the size of a blocking share) after Kazakhstan becomes a partner. He made it clear that Kazakhstan expects to have considerable influence in the consortium even if it is only to be a second-tier investor. [Note: Governance issues also worry the consortium; namely, how to create a firewall between the GOK as regulator and the GOK as partner. End Note].

17. (SBU) The Ambassador also asked Kulibayev what KMG's plans were for financing the purchase. Kulibayev did not indicate that KMG viewed the escalating price of the stake, or the approaching March deadline as a problem. He seemed to think that KMG would be able to use its own cash, although he did not exclude the idea of borrowing some part of the money needed, particularly for subsequent cash calls.

Comment

18. (SBU) As usual, Shkolnik was voluble and gregarious in this meeting. However, he displayed some frustration, saying that virtually every party he mentioned (Azerbaijan, ExxonMobil, ChevronTexaco, Russia, the Kashagan consortium) needed to show more flexibility and appreciate the advantages of working with Kazakhstan. In particular, he seems to view the prospect of Rosneft becoming Russia's agent on CPC with trepidation; and he clearly wants the Russian side locked into commitments on the remaining expansion issues before that happens. We did not have advance notice that Kulibayev would attend the meeting. His interjections were brief but he gave every impression of confidence that the issues with Azerbaijan would work themselves out and particularly that KMG could finance the Kashagan deal without difficulty. End comment.

ORDWAY

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